Fee vs. commission: No doubt which investors prefer

A new survey by Cerulli Associates asked investors whether they prefer paying fees or commissions to their advisers. The result? It wasn't even close.

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Investors would rather pay commissions for the financial advice they receive than a fee based on assets under management, said Cerulli Associates.

About 47 percent of 7,800 households surveyed prefer paying commissions, compared with 27 percent that would rather contribute a fee based on assets, according to the report released today by the Boston-based research firm. About 18 percent said they prefer paying retainer fees, which are generally lump sums negotiated between advisers and clients, and 8 percent said they opt for an hourly fee structure.

“Investors don’t like the idea of paying a fee forever,” said Scott Smith, associate director for Cerulli. “I think it rubs them the wrong way until the benefits are explained.”

The financial advice industry has been moving towards a fee-based model in recent years, the report said. In 2010 about 66 percent of all providers of financial advice were compensated only or primarily by fees compared with 46 percent in 2003.

"If you're only going to trade five or seven times a year, it's probably more economical for you to pay a commission as opposed to paying someone one percent of your assets as a management fee," said Ira Hammerman, general counsel for the Securities Industry and Financial Markets Association, the lobbying group for the brokerage industry.

Free Advice

About 33 percent of investors surveyed said they didn't know how they pay for the investment advice they receive, and 31 percent said they thought their adviser or broker provided investment advice for free. Those who were unsure of how they pay for advice were most likely to be unhappy with their financial adviser, with 47 percent reporting dissatisfaction, the study said. About 27 percent of those who said they pay commissions reported being dissatisfied.

"Somebody who hands their adviser a check and hopes for the best is unlikely to have been very happy in the last few years," Smith said.

About 64 percent of those surveyed said they believe their financial adviser is held to a fiduciary standard of care, and 63 percent of clients of the largest broker-dealers said they thought that as well.

Brokers currently must meet a standard to offer clients "suitable investments," whereas registered investment advisers have a fiduciary obligation to put clients' best interests first.

Common Standard

In January, the U.S. Securities and Exchange Commission released a report recommending a common fiduciary standard for brokers and registered investment advisers who provide personalized investment advice. The SEC is scheduled to propose a rule on the standard between August and the end of the year, according to its website. Holding brokers to a fiduciary standard won't preclude them from accepting commissions, the SEC report said.

"Our clients have consistently indicated that they want choice in how they purchase and pay for wealth management services," said Christine Pollak, a spokeswoman for Morgan Stanley Smith Barney, the world's largest brokerage.

Investors who say they prefer commissions may not realize how much they're paying in terms of dollars, said Ellen Turf, chief executive officer of the National Association of Personal Financial Advisors, a network of fee-only financial planners.

"I think it's a psychological thing," she said. "I think the average consumer really doesn't understand."

The Cerulli study was based on a Phoenix Marketing International survey conducted between August and December 2010 that focused on households with more than $50,000 in annual income or more than $250,000 in investable assets.

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